

TOOTSIE ROLL INDUSTRIES INC  
Form 10-Q  
November 07, 2012  
[Table of Contents](#)

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

For the quarterly period ended September 29, 2012

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

For the transition period from            to

COMMISSION FILE NUMBER 1-1361

**Tootsie Roll Industries, Inc.**

(Exact Name of Registrant as Specified in its Charter)

Edgar Filing: TOOTSIE ROLL INDUSTRIES INC - Form 10-Q

**VIRGINIA**  
(State of Incorporation)

**22-1318955**  
(I.R.S. Employer Identification No.)

**7401 South Cicero Avenue, Chicago, Illinois**  
(Address of Principal Executive Offices)

**60629**  
(Zip Code)

**773-838-3400**

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files) Yes  No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "accelerated filer," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date (September 29, 2012).

| Class                                     | Outstanding |
|---|-------------|
| Common Stock, \$.69 4/9 par value         | 36,997,779  |
| Class B Common Stock, \$.69 4/9 par value | 21,629,133  |

Table of Contents

**TOOTSIE ROLL INDUSTRIES, INC. AND SUBSIDIARIES**

September 29, 2012

**INDEX**

|                                     | <b>Page No.</b>   |
|-------------------------------------|---|
| <b><u>Part I</u></b>                |   |
| <b><u>Financial Information</u></b> |   |
| <b><u>Item 1.</u></b>               |   |
|                                     | <b><u>Financial Statements:</u></b>   |
|                                     | <b><u>Condensed Consolidated Statements of Financial Position</u></b> 3-4                                     |
|                                     | <b><u>Condensed Consolidated Statements of Earnings, Comprehensive Earnings and Retained Earnings</u></b> 5-6 |
|                                     | <b><u>Condensed Consolidated Statements of Cash Flows</u></b> 7   |
|                                     | <b><u>Notes to Condensed Consolidated Financial Statements</u></b> 8-13                                       |
| <b><u>Item 2.</u></b>               | <b><u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b> 14-18     |
| <b><u>Item 3.</u></b>               | <b><u>Quantitative and Qualitative Disclosures About Market Risk</u></b> 18                                   |
| <b><u>Item 4.</u></b>               | <b><u>Controls and Procedures</u></b> 18  |
| <b><u>Part II</u></b>               | <b><u>Other Information</u></b>   |
| <b><u>Item 2.</u></b>               | <b><u>Unregistered Sales of Equity Securities and Use of Proceeds</u></b> 19                                  |
| <b><u>Item 6.</u></b>               | <b><u>Exhibits</u></b> 19   |
| <b><u>Signatures</u></b>            | 20  |
| <b>Certifications</b>               | 21-23   |

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. See Forward-Looking Statements under Part I Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations of this Quarterly Report on Form 10-Q.

Table of Contents

## PART I - FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## TOOTSIE ROLL INDUSTRIES, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(in thousands) (UNAUDITED)

|   | September 29, 2012 | December 31, 2011 | October 1, 2011   |
|---|--------------------|-------------------|-------------------|
| <b>ASSETS</b>   |                    |                   |                   |
| <b><u>CURRENT ASSETS</u></b>  |                    |                   |                   |
| Cash & cash equivalents   | \$ 37,124          | \$ 78,612         | \$ 25,690         |
| Investments   | 14,563             | 10,895            | 9,440             |
| Trade accounts receivable,<br>Less allowances of \$3,501, \$1,731 & \$2,621 | 111,578            | 41,895            | 96,743            |
| Other receivables   | 6,539              | 3,391             | 4,386             |
| Inventories, at cost  |                    |                   |                   |
| Finished goods & work in process  | 36,506             | 42,676            | 51,803            |
| Raw material & supplies   | 28,925             | 29,084            | 30,614            |
| Prepaid expenses  | 4,167              | 5,070             | 4,516             |
| Deferred income taxes   | 600                | 578               | 621               |
| <b>Total current assets</b>   | <b>240,002</b>     | <b>212,201</b>    | <b>223,813</b>    |
| <b><u>PROPERTY, PLANT &amp; EQUIPMENT, at cost</u></b>                      |                    |                   |                   |
| Land  | 21,694             | 21,939            | 21,542            |
| Buildings   | 107,962            | 107,567           | 102,798           |
| Machinery & equipment   | 323,277            | 322,993           | 305,582           |
| Construction in progress  | 9,566              | 2,598             | 21,831            |
|   | 462,499            | 455,097           | 451,753           |
| Less-accumulated depreciation   | 258,112            | 242,935           | 238,395           |
| <b>Net property, plant and equipment</b>                                    | <b>204,387</b>     | <b>212,162</b>    | <b>213,358</b>    |
| <b><u>OTHER ASSETS</u></b>  |                    |                   |                   |
| Goodwill  | 73,237             | 73,237            | 73,237            |
| Trademarks  | 175,024            | 175,024           | 175,024           |
| Investments   | 126,387            | 96,161            | 98,523            |
| Split dollar officer life insurance   | 70,549             | 74,209            | 74,429            |
| Prepaid expenses  | 680                | 3,212             | 4,029             |
| Equity method investment  | 2,958              | 3,935             | 4,325             |
| Deferred income taxes   | 8,015              | 7,715             | 8,291             |
| <b>Total other assets</b>   | <b>456,850</b>     | <b>433,493</b>    | <b>437,858</b>    |
| <b>Total assets</b>   | <b>\$ 901,239</b>  | <b>\$ 857,856</b> | <b>\$ 875,029</b> |

**(The accompanying notes are an integral part of these statements.)**

Table of Contents(in thousands except per share data) **(UNAUDITED)**

|  | September 29, 2012 | December 31, 2011 | October 1, 2011 |
|--|--------------------|-------------------|-----------------|
| <b><u>LIABILITIES AND SHAREHOLDERS EQUITY</u></b>  |                    |                   |                 |
| <b><u>CURRENT LIABILITIES</u></b>  |                    |                   |                 |
| Accounts payable   | \$ 18,050          | \$ 10,683         | \$ 17,421       |
| Dividends payable  | 4,689              | 4,603             | 4,627           |
| Accrued liabilities  | 49,891             | 43,069            | 47,773          |
| Income taxes payable   | 8,137              |                   | 3,661           |
| Total current liabilities  | 80,767             | 58,355            | 73,482          |
| <b><u>NONCURRENT LIABILITIES</u></b>   |                    |                   |                 |
| Deferred income taxes  | 43,265             | 43,521            | 46,346          |
| Postretirement health care and life insurance benefits   | 28,362             | 26,108            | 22,256          |
| Industrial development bonds   | 7,500              | 7,500             | 7,500           |
| Liability for uncertain tax positions  | 8,019              | 8,345             | 9,560           |
| Deferred compensation and other liabilities  | 54,665             | 48,092            | 45,110          |
| Total noncurrent liabilities   | 141,811            | 133,566           | 130,772         |
| <b><u>SHAREHOLDERS EQUITY</u></b>  |                    |                   |                 |
| Common stock, \$.69-4/9 par value- 120,000 shares authorized; 36,998, 36,479 & 36,807, respectively, issued        | 25,693             | 25,333            | 25,560          |
| Class B common stock, \$.69-4/9 par value- 40,000 shares authorized; 21,629, 21,025 & 21,032, respectively, issued | 15,020             | 14,601            | 14,606          |
| Capital in excess of par value   | 556,771            | 533,677           | 541,362         |
| Retained earnings  | 101,171            | 114,269           | 108,599         |
| Accumulated other comprehensive loss   | (18,002)           | (19,953)          | (17,360)        |
| Treasury stock (at cost)- 73, 71 & 71 shares, respectively   | (1,992)            | (1,992)           | (1,992)         |
| Total shareholders equity  | 678,661            | 665,935           | 670,775         |
| Total liabilities and shareholders equity  | \$ 901,239         | \$ 857,856        | \$ 875,029      |

(The accompanying notes are an integral part of these statements.)

Table of Contents

**TOOTSIE ROLL INDUSTRIES, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF**  
**EARNINGS, COMPREHENSIVE EARNINGS AND RETAINED EARNINGS**  
(in thousands except per share amounts) **(UNAUDITED)**

|  | Quarter Ended      |                 |
|--|--------------------|-----------------|
|  | September 29, 2012 | October 1, 2011 |
| Net product sales  | \$ 200,274         | \$ 186,784      |
| Rental and royalty revenue   | 908                | 1,072           |
| <b>Total revenue</b>   | <b>201,182</b>     | <b>187,856</b>  |
| Product cost of goods sold   | 135,852            | 132,230         |
| Rental and royalty cost  | 232                | 264             |
| <b>Total costs</b>   | <b>136,084</b>     | <b>132,494</b>  |
| Product gross margin   | 64,422             | 54,554          |
| Rental and royalty gross margin                                    | 676                | 808             |
| <b>Total gross margin</b>  | <b>65,098</b>      | <b>55,362</b>   |
| Selling, marketing and administrative expenses                     | 32,685             | 25,425          |
| Earnings from operations   | 32,413             | 29,937          |
| Other income (expense), net  | 1,537              | (3,777)         |
| Earnings before income taxes                                       | 33,950             | 26,160          |
| Provision for income taxes   | 11,027             | 7,305           |
| Net earnings   | 22,923             | 18,855          |
| Net earnings per share   | \$ 0.39            | \$ 0.32         |
| Dividends per share *  | \$ 0.08            | \$ 0.08         |
| Average number of shares outstanding                               | 58,714             | 59,535          |
| <b>Other comprehensive income (loss), before tax</b>               |                    |                 |
| Foreign currency translation adjustments                           | 1,303              | (3,554)         |
| Unrealized gains (losses) for the period on investments            | 869                | (68)            |
| Less: reclassification adjustment for (gains) losses in net income |                    |                 |
| Unrealized gains (losses) on investments                           | 869                | (68)            |
| Unrealized gains (losses) for the period on derivatives            | 73                 | 314             |
| Less: reclassification adjustment for (gains) losses in net income | 41                 | (1,551)         |
| Unrealized gains (losses) on derivatives                           | 114                | (1,237)         |
| <b>Total other comprehensive income (loss), before tax</b>         | <b>2,286</b>       | <b>(4,859)</b>  |

Edgar Filing: TOOTSIE ROLL INDUSTRIES INC - Form 10-Q

|   |    |         |    |         |
|---|----|---------|----|---------|
| Income tax benefit (expense) related to items of other comprehensive income |    | (378)   |    | 599     |
| Comprehensive earnings  | \$ | 24,831  | \$ | 14,595  |
| Retained earnings at beginning of period                                    | \$ | 82,931  | \$ | 94,366  |
| Net earnings  |    | 22,923  |    | 18,855  |
| Cash dividends  |    | (4,683) |    | (4,622) |
| Stock dividends   |    |         |    |         |
| Retained earnings at end of period  | \$ | 101,171 | \$ | 108,599 |

\*Does not include 3% stock dividend to shareholders of record on 3/6/12 and 3/8/11.

(The accompanying notes are an integral part of these statements.)



Table of Contents

**TOOTSIE ROLL INDUSTRIES, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF**

**EARNINGS, COMPREHENSIVE EARNINGS AND RETAINED EARNINGS**

**(in thousands except per share amounts) (UNAUDITED)**

|  | Year to Date Ended |                 |
|--|--------------------|-----------------|
|  | September 29, 2012 | October 1, 2011 |
| Net product sales  | \$ 418,193         | \$ 399,991      |
| Rental and royalty revenue   | 2,948              | 3,080           |
| <b>Total revenue</b>   | <b>421,141</b>     | <b>403,071</b>  |
| Product cost of goods sold   | 283,615            | 276,740         |
| Rental and royalty cost  | 739                | 772             |
| <b>Total costs</b>   | <b>284,354</b>     | <b>277,512</b>  |
| Product gross margin   | 134,578            | 123,251         |
| Rental and royalty gross margin                                    | 2,209              | 2,308           |
| <b>Total gross margin</b>  | <b>136,787</b>     | <b>125,559</b>  |
| Selling, marketing and administrative expenses                     | 84,946             | 77,560          |
| Earnings from operations   | 51,841             | 47,999          |
| Other income, net  | 4,428              | 216             |
| Earnings before income taxes                                       | 56,269             | 48,215          |
| Provision for income taxes   | 17,061             | 14,544          |
| Net earnings   | 39,208             | 33,671          |
| Net earnings per share   | \$ 0.67            | \$ 0.56         |
| Dividends per share *  | \$ 0.24            | \$ 0.24         |
| Average number of shares outstanding                               | 58,893             | 59,692          |
| <b>Other comprehensive income (loss), before tax</b>               |                    |                 |
| Foreign currency translation adjustments                           | 1,644              | (2,104)         |
| Unrealized gains (losses) for the period on investments            | 837                | 1,708           |
| Less: reclassification adjustment for (gains) losses in net income |                    |                 |
| Unrealized gains (losses) on investments                           | 837                | 1,708           |
| Unrealized gains (losses) for the period on derivatives            | (120)              | (545)           |
| Less: reclassification adjustment for (gains) losses in net income | (241)              | (7,552)         |
| Unrealized gains (losses) on derivatives                           | (361)              | (8,097)         |
| <b>Total other comprehensive loss, before tax</b>                  | <b>2,120</b>       | <b>(8,493)</b>  |

Edgar Filing: TOOTSIE ROLL INDUSTRIES INC - Form 10-Q

|  |           |                 |           |                 |
|--|-----------|-----------------|-----------|-----------------|
| <b>Income tax benefit related to items of other comprehensive income</b> |           | <b>(169)</b>    |           | <b>2,346</b>    |
| <b>Comprehensive earnings</b>  | <b>\$</b> | <b>41,159</b>   | <b>\$</b> | <b>27,524</b>   |
| <b>Retained earnings at beginning of period</b>                          | <b>\$</b> | <b>114,269</b>  | <b>\$</b> | <b>135,866</b>  |
| <b>Net earnings</b>  |           | <b>39,208</b>   |           | <b>33,671</b>   |
| <b>Cash dividends</b>  |           | <b>(13,972)</b> |           | <b>(13,763)</b> |
| <b>Stock dividends</b>   |           | <b>(38,334)</b> |           | <b>(47,175)</b> |
| <b>Retained earnings at end of period</b>                                | <b>\$</b> | <b>101,171</b>  | <b>\$</b> | <b>108,599</b>  |

---

\*Does not include 3% stock dividend to shareholders of record on 3/6/12 and 3/8/11.

(The accompanying notes are an integral part of these statements.)

Table of Contents

## TOOTSIE ROLL INDUSTRIES, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands) (UNAUDITED)

|   | Year to Date Ended |                 |
|---|--------------------|-----------------|
|   | September 29, 2012 | October 1, 2011 |
| <b><u>CASH FLOWS FROM OPERATING ACTIVITIES:</u></b>                             |                    |                 |
| Net earnings  | \$ 39,208          | \$ 33,671       |
| Adjustments to reconcile net earnings to net cash used in operating activities: |                    |                 |
| Depreciation and amortization   | 14,992             | 14,465          |
| (Gain) loss from equity method investment                                       | 963                | (24)            |
| Amortization of marketable security premiums                                    | 1,318              | 893             |
| Changes in operating assets and liabilities:                                    |                    |                 |
| Accounts receivable   | (69,113)           | (60,001)        |
| Other receivables   | (3,508)            | 2,692           |
| Inventories   | 6,696              | (26,376)        |
| Prepaid expenses and other assets   | 7,009              | 4,571           |
| Accounts payable and accrued liabilities  | 13,906             | 11,609          |
| Income taxes payable and deferred   | 7,272              | (145)           |
| Postretirement health care and life insurance benefits                          | 2,254              | 1,567           |
| Deferred compensation and other liabilities                                     | 2,403              | 1,447           |
| Other   | 715                | (789)           |
| Net cash from (used in) operating activities                                    | 24,115             | (16,420)        |
| <b><u>CASH FLOWS FROM INVESTING ACTIVITIES:</u></b>                             |                    |                 |
| Capital expenditures  | (7,008)            | (12,677)        |
| Net purchases of trading securities   | (2,489)            | (2,967)         |
| Purchase of available-for-sale securities                                       | (33,502)           | (38,722)        |
| Sale and maturity of available-for-sale securities                              | 5,743              | 4,559           |
| Net cash used in investing activities   | (37,256)           | (49,807)        |
| <b><u>CASH FLOWS FROM FINANCING ACTIVITIES:</u></b>                             |                    |                 |
| Shares purchased and retired  | (14,363)           | (10,271)        |
| Dividends paid in cash  | (13,984)           | (13,788)        |
| Net cash used in financing activities   | (28,347)           | (24,059)        |
| Decrease in cash and cash equivalents   | (41,488)           | (90,286)        |
| Cash and cash equivalents at beginning of year                                  | 78,612             | 115,976         |
| Cash and cash equivalents at end of quarter                                     | \$ 37,124          | \$ 25,690       |
| <b>Supplemental cash flow information:</b>                                      |                    |                 |
| Income taxes paid, net  | \$ 10,651          | \$ 9,385        |
| Interest paid   | \$ 27              | \$ 33           |
| Stock dividend issued   | \$ 38,237          | \$ 47,053       |

**(The accompanying notes are an integral part of these statements.)**

Table of Contents

**TOOTSIE ROLL INDUSTRIES, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 29, 2012**

**(in thousands except per share amounts) (UNAUDITED)**

**Note 1 Significant Accounting Policies**

**General Information**

Foregoing data has been prepared from the unaudited financial records of Tootsie Roll Industries, Inc. and Subsidiaries (the Company) and in the opinion of management, all adjustments necessary for a fair statement of the results for the interim period have been reflected. All adjustments were of a normal and recurring nature. These consolidated financial statements should be read in conjunction with the consolidated financial statements and the related notes included in the Company's 2011 Annual Report on Form 10-K.

Results of operations for the period ended September 29, 2012 are not necessarily indicative of results to be expected for the year ending December 31, 2012 because of the seasonal nature of the Company's operations. Historically, the third quarter has been the Company's largest sales quarter due to Halloween sales.

**Accounting Pronouncements**

In May 2011, the Financial Accounting Standards Board (FASB) issued new accounting rules related to fair value measurements. The new accounting rules clarify some existing concepts, eliminate wording differences between Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS), and in some limited cases, change some principles to achieve convergence between GAAP and IFRS. The new accounting rules result in a consistent definition of fair value and common requirements for measurement of and disclosure about fair value between GAAP and IFRS. The new accounting rules also expand the disclosures for fair value measurements that are estimated using significant unobservable (Level 3) inputs. The adoption of the new accounting rules on January 1, 2012 did not have a material effect on the Company's financial condition, results of operations or cash flows.

In June 2011, the FASB issued new accounting rules that require an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income, or in two separate but consecutive statements. The new accounting rules eliminate the option to present components of other comprehensive income as part of the statement of equity. The adoption of the new accounting rules on January 1, 2012 did not have a material effect on the Company's financial condition, results of operations or cash flows.

In September 2011, the FASB issued new accounting rules related to testing goodwill for impairment. The new accounting rules permit an entity to first assess qualitative factors to determine if it is more likely than not that the fair value of a reporting unit is less than its carrying value. If it is concluded that this is the case, it is necessary to perform the two-step goodwill impairment test prescribed under current accounting rules. Otherwise, the two-step goodwill impairment test is not required. The adoption of the new accounting rules on January 1, 2012 did not have a material effect on the Company's financial condition, results of operations or cash flows.

In July 2012, the FASB issued amendments to the indefinite-lived intangible asset impairment guidance which provides an option for companies to use a qualitative approach to test indefinite-lived intangible assets for impairment if certain conditions are met. The amendments are effective for annual and interim indefinite-lived intangible asset impairment tests performed for fiscal years beginning after September 15, 2012 (early adoption is permitted). The implementation of the amended accounting guidance is not expected to have a material impact on the Company's financial condition, results of operations or cash flows.

#### Note 2 Average Shares Outstanding

Average shares outstanding for the period ended September 29, 2012 reflect stock purchases of 593 shares for \$14,364 and a 3% stock dividend distributed on April 5, 2012. Average shares outstanding for the period ended October 1, 2011 reflect stock purchases of 373 shares for \$10,271 and a 3% stock dividend distributed on April 7, 2011.

#### Note 3 Income Taxes

The Company is subject to taxation in the U.S. and various state and foreign jurisdictions. The Company remains subject to examination by U.S. federal and certain state tax authorities for the years 2008 through 2011. Certain foreign jurisdictions are subject to examinations for the years 2005 through 2011.

Table of Contents**Note 4 Fair Value Measurements**

Current accounting guidance defines fair value as the price that would be received in the sale of an asset, or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Guidance requires disclosure of the extent to which fair value is used to measure financial assets and liabilities, the inputs utilized in calculating valuation measurements, and the effect of the measurement of significant unobservable inputs on earnings, or changes in net assets, as of the measurement date. Guidance establishes a three-level valuation hierarchy based upon the transparency of inputs utilized in the measurement and valuation of financial assets or liabilities as of the measurement date. Level 1 inputs include quoted prices for identical instruments and are the most observable. Level 2 inputs include quoted prices for similar assets and observable inputs such as interest rates, foreign currency exchange rates, commodity rates and yield curves. Level 3 inputs are not observable in the market and include management's own judgments about the assumptions market participants would use in pricing the asset or liability. The use of observable and unobservable inputs is reflected in the hierarchy assessment disclosed in the table below.

As of September 29, 2012, December 31, 2011 and October 1, 2011, the Company held certain financial assets that are required to be measured at fair value on a recurring basis. These included derivative hedging instruments related to the purchase of certain raw materials and foreign currencies, investments in trading securities and available-for-sale securities, including an auction rate security. The Company's available-for-sale and trading securities principally consist of municipal bonds and mutual funds that are publicly traded.

The following table presents information about the Company's financial assets and liabilities measured at fair value as of September 29, 2012, December 31, 2011 and October 1, 2011, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value:

|   | Total<br>Fair Value | Estimated Fair Value September 29, 2012 |                   |          |
|---|---------------------|---|-------------------|----------|
|   |                     | Level 1                                 | Input Levels Used |          |
|   |                     |   | Level 2           | Level 3  |
| Cash and cash equivalents   | \$ 37,124           | \$ 37,124                               | \$                | \$       |
| Auction rate security   | 8,130               |   |                   | 8,130    |
| Available-for-sale securities excluding the auction rate security | 84,437              |   | 84,437            |          |
| Foreign currency forward contracts                                |                     |   |                   |          |
| Commodity futures contracts                                       | 48                  | 48                                      |                   |          |
| Commodity options contracts                                       | 100                 | 100                                     |                   |          |
| Trading securities  | 48,382              | 48,382                                  |                   |          |
| Total assets measured at fair value                               | \$ 178,221          | \$ 85,654                               | \$ 84,437         | \$ 8,130 |

|   | Total<br>Fair Value | Estimated Fair Value December 31, 2011 |                   |         |
|---|---------------------|--|-------------------|---------|
|   |                     | Level 1                                | Input Levels Used |         |
|   |                     |  | Level 2           | Level 3 |
| Cash and cash equivalents   | \$ 78,612           | \$ 78,612                              | \$                | \$      |
| Auction rate security   | 7,453               |  |                   | 7,453   |
| Available-for-sale securities excluding the auction rate security | 57,835              |  | 57,835            |         |
| Foreign currency forward contracts                                | 205                 |  | 205               |         |
| Commodity futures contracts                                       | 203                 | 203                                    |                   |         |
| Commodity options contracts                                       |                     |  |                   |         |

Edgar Filing: TOOTSIE ROLL INDUSTRIES INC - Form 10-Q

|  |           |                |           |                |           |               |           |              |
|--|-----------|----------------|-----------|----------------|-----------|---------------|-----------|--------------|
| <b>Trading securities</b>                  |           | <b>41,768</b>  |           | <b>41,768</b>  |           |               |           |              |
| <b>Total assets measured at fair value</b> | <b>\$</b> | <b>186,076</b> | <b>\$</b> | <b>120,583</b> | <b>\$</b> | <b>58,040</b> | <b>\$</b> | <b>7,453</b> |



Table of Contents

|  | Total<br>Fair Value | Estimated Fair Value October 1, 2011<br>Input Levels Used |           |          |
|--|---------------------|---|-----------|----------|
|  |                     | Level 1   | Level 2   | Level 3  |
| Cash and cash equivalents  | \$ 25,690           | \$ 25,690   | \$        | \$       |
| Auction rate security  | 8,130               |   |           | 8,130    |
| Available-for-sale securities excluding the<br>auction rate security | 60,802              |   | 60,802    |          |
| Foreign currency forward contracts                                   | (108)               |   | (108)     |          |
| Commodity futures contracts  | 345                 | 345   |           |          |
| Commodity options contracts  |                     |   |           |          |
| Trading securities   | 39,031              | 39,031  |           |          |
| Total assets measured at fair value                                  | \$ 133,890          | \$ 65,066   | \$ 60,694 | \$ 8,130 |

As of the end of third quarter 2012 the Company's long-term investments include \$8,130 (\$13,550 original cost) of Jefferson County Alabama Sewer Revenue Refunding Warrants, originally purchased with an insurance-backed AAA rating. This is an auction rate security that is classified as an available-for-sale security. Due to adverse events related to Jefferson County and its bond insurance carrier, Financial Guaranty Insurance Company (FGIC), as well as events in the credit markets, the auctions for this auction rate security have failed since 2008. As such, the Company continues to estimate the fair value of this auction rate security utilizing a valuation model with Level 3 inputs, as defined by guidance. This valuation model considered, among others items, a limited number of market trades, the credit risk of the collateral underlying the auction rate security, the credit risk of the bond insurer, interest rates, and the amount and timing of expected future cash flows including assumptions about the market expectation of the next successful auction or possible negotiated settlement between the County and debt holders. The trading range of these inputs was between 60% and 73% of the original par value. The Company continues to receive all contractual interest payments on this auction rate security on a timely basis, there has been no default, it is insured by FGIC and the Company has the intent and ability to hold this auction rate security until recovery of its amortized cost basis. Representatives of Jefferson County and the bondholders were in negotiations to reach a settlement agreeable to the bondholders and the insurers, and since a settlement could not be reached, the County filed for bankruptcy. FGIC is also in bankruptcy. Rulings by the bankruptcy court could have adverse effects to the holders of warrants and other debt, and further reduce the market value of this auction rate security resulting in an additional other-than-temporary impairments and charges to net earnings. The Company is not currently able to determine the outcome of this bankruptcy, or the amount and timing of the ultimate net proceeds that it may recover.

The following table presents additional information about the Company's financial instruments (Jefferson County auction rate security) measured at fair value on a recurring basis using significant unobservable inputs (Level 3) at September 29, 2012 and October 1, 2011:

|   | 2012     | 2011     |
|---|----------|----------|
| Balance at January 1                                | \$ 7,453 | \$ 6,775 |
| Unrealized gain in other comprehensive earnings     | 677      | 1,355    |
| Balance at September 29 and October 1, respectively | \$ 8,130 | \$ 8,130 |

The fair value of the Company's industrial revenue development bonds at September 29, 2012 and October 1, 2011 were valued using Level 2 inputs which approximates the carrying value of \$7,500 for both periods. Interest rates on these bonds reset weekly based on current market conditions.

## Note 5 Derivative Instruments and Hedging Activities

**From time to time, the Company uses derivative instruments, including foreign currency forward contracts, commodity futures contracts and commodity option contracts, to manage its exposures to foreign exchange and commodity prices. Commodity futures contracts and most commodity option contracts are intended and effective as hedges of market price risks associated with the anticipated purchase of certain raw materials (primarily sugar). Foreign currency forward contracts are intended and effective as hedges of the Company's exposure to the variability of cash flows, primarily related to the foreign exchange rate changes of products manufactured in Canada and sold in the United States, and periodic equipment purchases from foreign suppliers denominated in a foreign currency. The Company does not engage in trading or other speculative use of derivative instruments.**

Table of Contents

The Company recognizes all derivative instruments as either assets or liabilities at fair value in the Condensed Consolidated Statement of Financial Position. Derivative assets are recorded in other receivables and derivative liabilities are recorded in accrued liabilities. The Company uses either hedge accounting or mark-to-market accounting for its derivative instruments. Derivatives that qualify for hedge accounting are designated as cash flow hedges by formally documenting the hedge relationships, including identification of the hedging instruments, the hedged items and other critical terms, as well as the Company's risk management objectives and strategies for undertaking the hedge transaction.

Changes in the fair value of the Company's cash flow hedges are recorded in accumulated other comprehensive loss, net of tax, and are reclassified to earnings in the periods in which earnings are affected by the hedged item. Substantially all amounts reported in accumulated other comprehensive loss for commodity derivatives are expected to be reclassified to cost of goods sold. Substantially all amounts reported in accumulated other comprehensive loss for foreign currency derivatives are expected to be reclassified to other income, net.

The following table summarizes the Company's outstanding derivative contracts and their effects on its Condensed Consolidated Statements of Financial Position at September 29, 2012, December 31, 2011 and October 1, 2011:

|   | Notional<br>Amounts | September 29, 2012 |               |
|---|---------------------|--------------------|---------------|
|   |                     | Assets             | Liabilities   |
| <b>Derivatives designated as hedging instruments:</b>     |                     |                    |               |
| Commodity futures contracts                               | \$ 2,252            | \$ 53              | \$ (5)        |
| <b>Total derivatives designated as hedges</b>             |                     | <b>53</b>          | <b>(5)</b>    |
| <b>Derivatives not designated as hedging instruments:</b> |                     |                    |               |
| Commodity futures contracts                               | 841                 | 100                |               |
| <b>Total derivatives not designated as hedges</b>         |                     | <b>100</b>         |               |
| <b>Total derivatives</b>                                  |                     | <b>\$ 153</b>      | <b>\$ (5)</b> |

|   | Notional<br>Amounts | December 31, 2011 |                 |
|---|---------------------|-------------------|-----------------|
|   |                     | Assets            | Liabilities     |
| <b>Derivatives designated as hedging instruments:</b> |                     |                   |                 |
| Foreign currency forward contracts                    | \$ 13,044           | \$ 205            | \$              |
| Commodity futures contracts                           | 4,557               | 341               | (138)           |
| <b>Total derivatives</b>                              |                     | <b>\$ 546</b>     | <b>\$ (138)</b> |

|   | Notional<br>Amounts | October 1, 2011 |                 |
|---|---------------------|-----------------|-----------------|
|   |                     | Assets          | Liabilities     |
| <b>Derivatives designated as hedging instruments:</b> |                     |                 |                 |
| Foreign currency forward contracts                    | \$ 7,840            | \$              | \$ (108)        |
| Commodity futures contracts                           | 5,473               | 445             | (100)           |
| <b>Total derivatives</b>                              |                     | <b>\$ 445</b>   | <b>\$ (208)</b> |



Table of Contents

The effects of derivative instruments on the Company's Condensed Consolidated Statement of Earnings, Comprehensive Earnings and Retained Earnings for quarters and years to date ended September 29, 2012 and October 1, 2011 are as follows:

|                                    | For Quarter Ended September 29, 2012 |           |  |  |
|------------------------------------|--------------------------------------|-----------|--|--|
|                                    | Gain(Loss)<br>Recognized<br>in OCI   |           | Gain (Loss)<br>Reclassified from<br>Accumulated OCI<br>into Earnings | Gain (Loss)<br>on Amount Excluded<br>from Effectiveness<br>Testing Recognized<br>in Earnings |
| Foreign currency forward contracts | \$                                   | 94        | \$   | 164  |
| Commodity futures contracts        |                                      | (20)      |  | (200)  |
| Commodity option contracts         |                                      | (1)       |  | (5)  |
| <b>Total</b>                       | <b>\$</b>                            | <b>73</b> | <b>\$</b>  | <b>(41)</b>  |

|                                    | For Quarter Ended October 1, 2011   |            |  |  |
|------------------------------------|-------------------------------------|------------|--|--|
|                                    | Gain (Loss)<br>Recognized<br>in OCI |            | Gain (Loss)<br>Reclassified from<br>Accumulated OCI<br>into Earnings | Gain (Loss)<br>on Amount Excluded<br>from Effectiveness<br>Testing Recognized<br>in Earnings |
| Foreign currency forward contracts | \$                                  | (116)      | \$   | 359  |
| Commodity futures contracts        |                                     | 982        |  | 1,210  |
| Commodity option contracts         |                                     | (552)      |  | (18)   |
| <b>Total</b>                       | <b>\$</b>                           | <b>314</b> | <b>\$</b>  | <b>1,551</b>   |

|                                    | For Year to Date Ended September 29, 2012 |              |  |  |
|------------------------------------|---|--------------|--|--|
|                                    | Gain(Loss)<br>Recognized<br>in OCI        |              | Gain (Loss)<br>Reclassified from<br>Accumulated OCI<br>into Earnings | Gain (Loss)<br>on Amount Excluded<br>from Effectiveness<br>Testing Recognized<br>in Earnings |
| Foreign currency forward contracts | \$  | 222          | \$   | 428  |
| Commodity futures contracts        |   | (307)        |  | (152)  |
| Commodity option contracts         |   | (35)         |  | (35)   |
| <b>Total</b>                       | <b>\$</b>                                 | <b>(120)</b> | <b>\$</b>  | <b>241</b>   |

|                                    | For Year to Date Ended October 1, 2011 |         |  |  |
|------------------------------------|--|---------|--|--|
|                                    | Gain (Loss)<br>Recognized<br>in OCI    |         | Gain (Loss)<br>Reclassified from<br>Accumulated OCI<br>into Earnings | Gain (Loss)<br>on Amount Excluded<br>from Effectiveness<br>Testing Recognized<br>in Earnings |
| Foreign currency forward contracts | \$                                     | 4       | \$   | 1,054  |
| Commodity futures contracts        |  | 4,839   |  | 6,803  |
| Commodity option contracts         |  | (5,388) |  | (305)  |

|              |    |       |    |       |    |
|--------------|----|-------|----|-------|----|
| <b>Total</b> | \$ | (545) | \$ | 7,552 | \$ |
|--------------|----|-------|----|-------|----|

During the quarters and years to date ended September 29, 2012 and October 1, 2011, the Company recognized earnings/(losses) of \$27 and \$(16), and \$80 and \$172 respectively, related to mark-to-market accounting for certain commodity option and future contracts.

Table of Contents

**Note 6 Pension Plans**

In April 2012, the Company received an Annual Funding Notice and a Notice of Funded Status (Notices), as defined by the Pension Protection Act (PPA), from the Bakery and Confectionery Union and Industry International (BC&T) Pension Fund (Fund), a multi-employer defined benefit pension plan (Plan) for certain Company union employees. The Notices indicate that the Fund's actuary has certified that the Plan is 65.8% funded as of January 1, 2012. This funding percentage is based on actuarial values and not market values of investments which may be lower. As of January 1, 2011 the Plan was 83.6% funded based on the actuarial value of investments, however, it was only 70.0% funded based on the then current market value of its investments. The Fund's actuary has certified to the U.S. Department of the Treasury that the Plan is in critical status, the Red Zone, as defined by the PPA.

The Trustees of the Fund (Trustees) have advised that one of the largest contributors to the Fund filed for bankruptcy and ceased making contributions to the Fund in 2011, and that the Fund has achieved less favorable investment performance returns needed to maintain a favorable funding status. The Trustees have advised that the aforementioned are some of the reasons for the Fund's deterioration to critical status. As of January 1, 2011 plan valuation date, the BC&T Plan had 116,708 participants, of which 32,449 (28%) were active participants, 54,470 (47%) were retired or separated from service and receiving benefits, and 29,789 (26%) were retired or separated from service and entitled to receive future benefits. The PPA requires that plans in critical status develop a plan to improve the Fund's funded status, including that contributing employers pay a surcharge to help correct the plan's financial situation. In the event that a plan does not have the financial resources to pay benefits at a level specified by law then it must apply to the Pension Benefits Guaranty Corporation for government financial assistance.

The Company's contributions to the Fund increased to reflect a 5% surcharge effective June 1, 2012, and an additional 5% surcharge will become effective January 1, 2013. Company contributions to the Fund were \$2,046 and \$1,923 in calendar years 2011 and 2010, respectively. The Company was further advised by the BC&T Plan that if the Company had withdrawn from the Plan in 2011 its withdrawal liability, as defined, would have been \$21,120. The Company was further advised by the Plan that its withdrawal liability for the current calendar year was estimated to be \$37,200. Although the Company does not currently plan to withdraw from the Plan, the Company is exploring various alternatives, including the withdrawal from this Plan. Should the Company actually withdraw from the plan at a future date, a withdrawal liability would be payable to the Plan. The Company is currently unable to determine the ultimate outcome to the above discussed matter and therefore, is unable to determine the effects on its consolidated financial statements, but, the ultimate outcome could be material to its consolidated results of operations in one or more periods.

Table of Contents

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

This financial review discusses the Company's financial condition, results of operations, liquidity and capital resources, new accounting pronouncements and other matters. Dollars are presented in thousands, except per share amounts. It should be read in conjunction with the accompanying Condensed Consolidated Financial Statements and related footnotes.

Net product sales were \$200,274 in third quarter 2012 compared to \$186,784 in third quarter 2011, an increase of \$13,490 or 7.2%. Nine months 2012 net product sales were \$418,193 compared to \$399,991 in nine months 2011, an increase of \$18,202 or 4.6%. Third quarter and year to date 2012 benefited from effective marketing and sales programs, including back-to-school and pre-Halloween programs, and price increases needed to recover rising commodity and other input costs experienced in recent years. Third quarter and nine months 2012 net product sales were also favorably affected by the timing of certain customer sales in third and fourth quarter 2012.

Product cost of goods sold were \$135,852 in third quarter 2012 compared to \$132,230 in third quarter 2011, and nine months 2012 product cost of goods sold were \$283,615 compared to \$276,740 in nine months 2011. Product cost of goods sold includes \$407 and \$(915) of deferred compensation expense (income) in third quarter 2012 and 2011, respectively, and \$923 and \$(497) of deferred compensation expense (income) in nine months 2012 and 2011, respectively. Changes in deferred compensation expense principally result from the increase or decrease in the market value of investments in trading securities relating to compensation deferred in previous years and are not reflective of current operating results. Adjusting for the aforementioned changes in deferred compensation expense, product cost of goods sold increased from \$133,145 in third quarter 2011 to \$135,445 in third quarter 2012, an increase of \$2,300 or 1.7%; and increased from \$277,237 in nine months 2011 to \$282,692 in nine months 2012, an increase of \$5,455 or 2.0%. As a percentage of net product sales, adjusted product cost of goods sold was 67.6% in third quarter 2012 compared to 71.3% in third quarter 2011, a favorable improvement of 3.7% as a percentage of sales; and adjusted product cost of goods sold was 67.6% in nine months 2012 compared to 69.3% in nine months 2011 as a percent of sales, also a favorable improvement of 1.7% as a percent of sales. Although ingredient costs moderated in third quarter 2012 compared to third quarter 2011, nine months 2012 ingredient costs were approximately equal in the aggregate with nine months 2011. Plant overhead costs charged to third quarter and nine months 2012 cost of sales were higher compared to the corresponding periods in the prior year.

Selling, marketing and administrative expenses were \$32,685 in third quarter 2012 compared to \$25,425 in third quarter 2011, and nine months 2012 were \$84,946 compared to \$77,560 in nine months 2011. Selling, marketing and administrative expenses includes \$1,413 and \$(3,375) of deferred compensation expense (income) in third quarter 2012 and 2011, respectively, and \$3,202 and \$(1,942) of deferred compensation expense (income) in nine months 2012 and 2011, respectively. As discussed above, these changes in deferred compensation expense principally result from changes in the market value of investments in trading securities relating to compensation deferred in previous years and are not reflective of current operating results. Adjusting for the aforementioned changes in deferred compensation expense, selling, marketing and administrative expenses increased from \$28,800 in third quarter 2011 to \$31,273 in third quarter 2012, an increase of \$2,473 or 8.6%; and selling, marketing and administrative expenses increased from \$79,502 in nine months 2011 to \$81,745 in nine months 2012, an increase of \$2,243 or 2.8%. As a percentage of net product sales, adjusted selling, marketing and administrative expenses increased from 15.4% in third quarter 2011 to 15.6% in third quarter 2012, an increase of 0.2% as a percent of sales; and adjusted selling, marketing and administrative expenses decreased from 19.9% in nine months 2011 to 19.5% in nine months 2012, a decrease of 0.4%. Selling marketing and administrative expenses reflect higher rates and unit costs for freight and delivery expenses, including higher fuel surcharges, relating to customer deliveries. In addition, these expenses also reflect an increase in the allowance for uncollectable accounts (trade accounts receivable) for the third quarter and nine months 2012 periods compared to the corresponding periods in the prior year.



Earnings from operations were \$32,413 in third quarter 2012 compared to \$29,937 in third quarter 2011, and were \$51,841 in nine months 2012 compared to \$47,999 in nine months 2011. Earnings from operations include deferred compensation expenses relating to corresponding changes in the market value of trading securities that hedge these liabilities as discussed above. Adjusting for the aforementioned, operating earnings were \$34,233 and \$25,647 in third quarter 2012 and 2011, respectively, an increase of \$8,586 or 33.5%; and operating earnings were \$55,966 and \$45,560 in nine months 2012 and 2011, respectively, an increase of \$10,406 or 22.8%. As a percentage of net product sales, these adjusted operating earnings were 17.1% and 13.7% in third quarter 2012 and 2011, respectively, a favorable increase of 3.4% as a percentage of net product sales; and operating earnings were 13.3% and 11.4% in nine months 2012 and 2011, respectively, a favorable increase of 1.9% as a percentage of net product sales. The above discussed increases in adjusted operating earnings principally reflect the favorable impact of higher sales, including price increases as discussed above, partially offset by certain higher input costs primarily relating to plant overhead and freight and delivery as discussed above. Management believes the presentation in this and the preceding paragraphs relating to amounts adjusted for deferred compensation expense better reflects controllable costs affecting operating results for the third quarter and nine months 2012 as compared to the corresponding prior year third quarter and nine month period and, accordingly, provides additional insight of the underlying operations of the Company.

Table of Contents

Other income (expense), net, was \$1,537 in third quarter 2012 compared to \$(3,777) in third quarter 2011, a favorable change of \$5,314; and Other income, net, was \$4,428 in nine months 2012 compared to \$216 in nine months 2011, a favorable change of \$4,212. Other income, net, includes gains (losses) in trading securities of \$1,820 and \$(4,290) for third quarter 2012 and 2011, respectively, and gains (losses) in trading securities of \$4,125 and \$(2,439) for nine months 2012 and 2011, respectively. Changes relating to trading securities principally reflect changes in the fair value of trading securities investments which are used as an economic hedge for deferred compensation liabilities, and are substantially offset by a like amount of deferred compensation (expense) or income included in product cost of goods sold and selling, marketing, and administrative expenses in the respective periods as discussed above. Such changes principally reflect market appreciation or depreciation in the equity markets in the respective periods.

Other income, net, includes gains (losses) in foreign exchange of \$(175) and \$302 for third quarter 2012 and 2011, respectively, and \$238 and \$1,613 for nine months 2012 and 2011, respectively.

Other income, net, for third quarter 2012 and 2011 includes the results of the Company's 50% share of two Spanish companies which are accounted for using the equity method. Net earnings include these equity method gains (losses) of \$(374) and \$(109) for third quarter 2012 and 2011 respectively, and \$(963) and \$24 for nine months 2012 and 2011, respectively. Management believes that the economic situation in Spain is likely to result in additional equity method losses in the future, and that the Company's equity investment (carrying value of \$2,958 as of September 29, 2012) could suffer an impairment loss at a future date. The Company is currently unable to determine the ultimate outcome to the above discussed matter and therefore, is unable to determine the effects on its consolidated financial statements.

The consolidated effective tax rates were 32.5% and 27.9% in third quarter 2012 and 2011, respectively, and 30.3% and 30.2% in nine months 2012 and 2011, respectively.

Net earnings were \$22,923 in third quarter 2012 compared to \$18,855 in third quarter 2011, and earnings per share were \$0.39 and \$0.32 in third quarter 2012 and third quarter 2011, respectively, an increase of \$0.07 per share or 21.9%. Nine months 2012 net earnings were \$39,208 compared to nine months 2011 net earnings of \$33,671, a \$5,537 or 16.4% increase. Nine months net earnings per share were \$0.67 in 2012 compared to \$0.56 per share in nine months 2011, an increase of \$0.11 per share or 19.6%. Earnings per share for third quarter and nine months 2012 did benefit from the reduction in average shares outstanding resulting from common stock purchases in the open market by the Company. Average shares outstanding decreased from 59,535 in third quarter 2011 to 58,714 in third quarter 2012, and from 59,692 in nine months 2011 to 58,893 in nine months 2012.

Goodwill and intangibles are assessed annually as of December 31 or whenever events or circumstances indicate that the carrying values may not be recoverable from future cash flows. The Company has not ascertained any triggering events, as defined, or other adverse information that would indicate a material impairment of its goodwill or intangibles in third quarter or nine months 2012.

In April 2012, the Company received an Annual Funding Notice and a Notice of Funded Status (Notices), as defined by the Pension Protection Act (PPA), from the Bakery and Confectionery Union and Industry International (BC&T) Pension Fund (Fund), a multi-employer defined benefit pension plan (Plan) for certain Company union employees. The Notices indicate that the Fund's actuary has certified that the Plan is 65.8% funded as of January 1, 2012. This funding percentage is based on actuarial values and not market values of investments which may be lower. As of January 1, 2011 the Plan was 83.6% funded based on the actuarial value of investments, however, it was only 70.0% funded based on the then current market value of its investments. The Fund's actuary has certified to the U.S. Department of the Treasury that the Plan is in critical status, the Red Zone, as defined by the PPA.

The Trustees of the Fund (Trustees) have advised that one of the largest contributors to the Fund filed for bankruptcy and ceased making contributions to the Fund in 2011, and that the Fund has achieved less favorable investment performance returns needed to maintain a favorable funding status. The Trustees have advised that the aforementioned are some of the reasons for the Fund's deterioration to critical status. As of January 1, 2011 plan valuation date, the BC&T Plan had 116,708 participants, of which 32,449 (28%) were active participants, 54,470 (47%) were retired or separated from service and receiving benefits, and 29,789 (26%) were retired or separated from service and entitled to receive future benefits. The PPA requires that plans in critical status develop a plan to improve the Fund's funded status, including that contributing employers pay a surcharge to help correct the plan's financial situation. In the event that a plan does not have the financial resources to pay benefits at a level specified by law then it must apply to the Pension Benefits Guaranty Corporation for government financial assistance.

The Company's contributions to the Fund increased to reflect a 5% surcharge effective June 1, 2012, and an additional 5% surcharge will become effective January 1, 2013. Company contributions to the Fund were \$2,046 and \$1,923 in calendar years

Table of Contents

2011 and 2010, respectively. The Company was further advised by the BC&T Plan that if the Company had withdrawn from the Plan in 2011 its withdrawal liability, as defined, would have been \$21,120. The Company was further advised by the Plan that its withdrawal liability for the current calendar year was estimated to be \$37,200. Although the Company does not currently plan to withdraw from the Plan, the Company is exploring various alternatives, including the withdrawal from this Plan. Should the Company actually withdraw from the plan at a future date, a withdrawal liability would be payable to the Plan. The Company is currently unable to determine the ultimate outcome to the above discussed matter and therefore, is unable to determine the effects on its consolidated financial statements, but, the ultimate outcome could be material to its consolidated results of operations in one or more periods.

## LIQUIDITY AND CAPITAL RESOURCES

Net cash flows from (used in) operating activities were \$24,115 and \$(16,420) in nine months 2012 and 2011, respectively. The \$40,535 increase in cash flows from operating activities from nine months 2011 to nine months 2012 principally reflects changes in inventories as well as changes in other operating assets and liabilities, principally prepaid expenses and other assets, accounts payable and accrued liabilities, and income taxes payable and deferred. The change in inventories primarily results from benefits achieved from the Company's supply chain system which resulted in improved management of inventory levels. The increases in accounts receivable for the nine months 2012 and 2011 periods principally reflect the historical seasonality of the Company's higher third quarter sales relating to pre-Halloween sales.

Net cash used in investing activities was \$37,256 in nine months 2012 compared to \$49,807 in nine months 2011. Cash flows used in investing activities reflect \$33,502 and \$38,722 relating to the purchase of available-for-sale securities during nine months 2012 and 2011, respectively. Nine months 2012 and 2011 also includes capital expenditures of \$7,008 and \$12,677, respectively. Capital expenditures for the full 2012 year are anticipated to be generally in line with historical annualized spending, and are to be funded from the Company's cash flows from operations and internal sources.

The Company had no bank borrowings or repayments in nine months 2012 or 2011, and had no outstanding bank borrowings as of the end of third quarter 2012 or third quarter 2011.

Financing activities include Company common stock purchases and retirements of \$14,363 and \$10,271 in nine months 2012 and 2011, respectively. Cash dividends of \$13,984 and \$13,788 were paid in nine months 2012 and 2011, respectively. The increase in cash dividends reflects the annual 3% stock dividend issued in each of the years less the effects of Company common stock purchases and retirements.

The Company's current ratio (current assets divided by current liabilities) was 3.0 to 1 as of the end of third quarter 2012 as compared to 3.6 to 1 as of the end of fourth quarter 2011 and 3.0 to 1 as of the end of third quarter 2011. Net working capital was \$159,235 as of the end of third quarter 2012 as compared to \$153,846 and \$150,331 as of the end of fourth and third quarters 2011, respectively.

The aforementioned net working capital amounts are principally reflected in aggregate cash and cash equivalents and short-term investments which totaled \$51,687 as of the end of third quarter 2012 compared to \$89,507 and \$35,130 as of the end of fourth and third quarters 2011, respectively. In addition, long term investments, principally debt securities comprising municipal bonds (including

\$8,130 of Jefferson County auction rate securities discussed below) and trading securities, were \$126,387 as of the end of third quarter 2012, as compared to \$96,161 and \$98,523 as of the end of fourth and third quarters 2011, respectively. Aggregate cash and cash equivalents and short and long-term investments were \$178,074 as of the end of third quarter 2012, as compared to \$185,668 and \$133,653, as of the end of fourth and third quarters 2011, respectively. The aforementioned includes \$48,382, \$41,768, and \$39,031 as of the end of the third quarter 2012, and fourth and third quarters 2011, respectively, relating to trading securities which are used as an economic hedge for the Company's deferred compensation liabilities. Investments in municipal bonds and other debt securities that matured during nine months 2012 and 2011 were generally used to purchase the Company's common stock or were replaced with debt securities of similar maturities.

During 2008, the Company contributed \$16,050 to a VEBA trust to fund the estimated future costs of certain employee health, welfare and other benefits. The Company used the funds, as well as investment income in this VEBA trust, to pay the actual cost of such benefits during 2012 and 2011 and will continue to do so in future periods. As of the end of the third quarter 2012, the VEBA trust holds \$3,401 of aggregate cash, cash equivalents and investments; this asset value is included in prepaid expenses in the Company's current and other assets.

As of the end of third quarter 2012 the Company's long-term investments include \$8,130 (\$13,550 original cost) of Jefferson County Alabama Sewer Revenue Refunding Warrants, originally purchased with an insurance-backed AAA rating. This is an auction rate security that is classified as an available-for-sale security. Due to adverse events related to Jefferson County and its bond insurance carrier, Financial Guaranty Insurance Company (FGIC), as well as events in the credit markets, the

Table of Contents

auctions for this auction rate security have failed since 2008. As such, the Company continues to estimate the fair value of this auction rate security utilizing a valuation model with Level 3 inputs, as defined by guidance. This valuation model considered, among others items, a limited number of market trades, the credit risk of the collateral underlying the auction rate security, the credit risk of the bond insurer, interest rates, and the amount and timing of expected future cash flows including assumptions about the market expectation of the next successful auction or possible negotiated settlement between the County and debt holders. The trading range of these inputs was between 60% and 73% of the original par value. The Company continues to receive all contractual interest payments on this auction rate security on a timely basis, there has been no default, it is insured by FGIC and the Company has the intent and ability to hold this auction rate security until recovery of its amortized cost basis. Representatives of Jefferson County and the bondholders were in negotiations to reach a settlement agreeable to the bondholders and the insurers, and since a settlement could not be reached, the County filed for bankruptcy. FGIC is also in bankruptcy. Rulings by the bankruptcy court could have adverse effects to the holders of warrants and other debt and further reduce the market value of this auction rate security resulting in an additional other-than-temporary impairments and charges to net earnings. The Company is not currently able to determine the outcome of this bankruptcy, or the amount and timing of the ultimate net proceeds that it may recover.

#### ACCOUNTING PRONOUNCEMENTS

In May 2011, the Financial Accounting Standards Board (FASB) issued new accounting rules related to fair value measurements. The new accounting rules clarify some existing concepts, eliminate wording differences between Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS), and in some limited cases, change some principles to achieve convergence between GAAP and IFRS. The new accounting rules result in a consistent definition of fair value and common requirements for measurement of and disclosure about fair value between GAAP and IFRS. The new accounting rules also expand the disclosures for fair value measurements that are estimated using significant unobservable (Level 3) inputs. The adoption of the new accounting rules on January 1, 2012 did not have a material effect on the Company's financial condition, results of operations or cash flows.

In June 2011, the FASB issued new accounting rules that require an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income, or in two separate but consecutive statements. The new accounting rules eliminate the option to present components of other comprehensive income as part of the statement of equity. The adoption of the new accounting rules on January 1, 2012 did not have a material effect on the Company's financial condition, results of operations or cash flows.

In September 2011, the FASB issued new accounting rules related to testing goodwill for impairment. The new accounting rules permit an entity to first assess qualitative factors to determine if it is more likely than not that the fair value of a reporting unit is less than its carrying value. If it is concluded that this is the case, it is necessary to perform the two-step goodwill impairment test prescribed under current accounting rules. Otherwise, the two-step goodwill impairment test is not required. The adoption of the new accounting rules on January 1, 2012 did not have a material effect on the Company's financial condition, results of operations or cash flows.

In July 2012, the FASB issued amendments to the indefinite-lived intangible asset impairment guidance which provides an option for companies to use a qualitative approach to test indefinite-lived intangible assets for impairment if certain conditions are met. The amendments are effective for annual and interim indefinite-lived intangible asset impairment tests performed for fiscal years beginning after September 15, 2012 (early adoption is permitted). The implementation of the amended accounting guidance is not expected to have a material impact on the Company's financial condition, results of operations or cash flows.

**RISK FACTORS**

The Company's operations and financial results are subject to a number of risks and uncertainties that could adversely affect the Company's operating results and financial condition. Significant risk factors, without limitations that could impact the Company, are the following: (i) significant competitive activity, including advertising, promotional and price competition, and changes in consumer demand for the Company's products; (ii) fluctuations in the cost and availability of commodities and ingredients, including the effects of adverse weather conditions, and packaging materials, and the ability to recover cost increases through product sales price increases; (iii) inherent risks in the marketplace, including uncertainties about trade and consumer acceptance of price increases and seasonal events such as Halloween; (iv) the effect of acquisitions on the Company's results of operations and financial condition; (v) the effect of changes in foreign currencies on the Company's foreign subsidiaries operating results, and the effect of the fluctuation of the Canadian dollar on products manufactured in Canada and marketed and sold in the United States in U.S. dollars; (vi) the Company's reliance on third party vendors for various goods and services, including commodities used for ingredients that are primarily grown or sourced from foreign locations; (vii) the Company's ability to successfully implement new production processes and lines, and new computer software systems; (viii) the effect of changes in assumptions, including discount rates, sales growth and profit margins and the

Table of Contents

capability to pass along higher ingredient and other input costs through price increases, relating to the Company's impairment testing and analysis of its goodwill and trademarks; (ix) changes in the confectionery marketplace including actions taken by major retailers and customers; (x) customer, consumer and competitor response to marketing programs and price and product weight adjustments, and new products; (xi) dependence on significant customers, including the volume and timing of their purchases, and availability of shelf space; (xii) increases in energy costs, including freight and delivery, that cannot be passed along to customers through increased prices due to competitive reasons; (xiii) any significant labor stoppages, strikes or production interruptions; (xiv) changes in governmental laws and regulations including taxes and tariffs; (xv) the adverse effects should the Company either voluntarily or involuntarily recall its product(s) from the marketplace; (xvi) the risk that the market value of Company's investments could decline including being classified as other-than-temporary as defined; (xvii) the Company's dependence on its enterprise resource planning computer system to manage its supply chain and customer deliveries, and the risk that the Company's information technology systems fail to perform adequately or the Company is unable to protect such information technology systems against data corruption, cyber-based attacks or network security breaches; (xviii) the potential effects of adverse rulings by the bankruptcy court relating to the investment in the Jefferson County auction rate security; (xix) the potential adverse effects on the Company of the plan to be developed by the Bakery and Confectionary Union and Industry Pension Fund Trustees to improve the funding status of the plan; (xx) the potential adverse effects of deteriorating economic conditions in Spain and the effects on the Company's equity investment in two 50% owned Spanish companies, and (xxi) the potential effects of current and future macroeconomic conditions and geopolitical events.

**FORWARD-LOOKING STATEMENTS**

This discussion and certain other sections contain forward-looking statements that are based largely on the Company's current expectations and are made pursuant to the safe harbor provision of the Private Securities Litigation Reform Act of 1995.

Forward-looking statements can be identified by the use of words such as anticipated, believe, expect, intend, estimate, project, and other words of similar meaning in connection with a discussion of future operating or financial performance and are subject to certain factors, risks, trends and uncertainties that could cause actual results and achievements to differ materially from those expressed in the forward-looking statements. Such factors, risks, trends and uncertainties, which in some instances are beyond the Company's control, include the overall competitive environment in the Company's industry, changes in assumptions and judgments discussed above under the heading Significant Accounting Policies and Estimates, and factors identified and referred to above under the heading Risk Factors.

The risk factors identified and referred to above are believed to be significant factors, but not necessarily all of the significant factors that could cause actual results to differ from those expressed in any forward-looking statement. Readers are cautioned not to place undue reliance on such forward-looking statements, which are made only as of the date of this report. The Company undertakes no obligation to update such forward-looking statements.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

The Company is exposed to various market risks, including fluctuations in sugar, corn syrup, edible oils, including soybean oil, cocoa, dextrose, milk and whey, and gum-base input ingredients and packaging and fuel costs principally relating to freight and delivery fuel surcharges. The Company is exposed to exchange rate fluctuations in the Canadian dollar which is the currency used for a portion of the raw material and packaging material costs and operating expenses at its Canadian plants. The Company invests in securities with maturities or auction dates of up to three years, the majority of which are held to maturity, which limits the Company's exposure to interest rate fluctuations. There has been no material change in the Company's market risks that would significantly affect the disclosures made in the Form 10-K for the year ended December 31, 2011.



**ITEM 4. CONTROLS AND PROCEDURES**

Under the supervision and with the participation of management, the Chief Executive Officer and Chief Financial Officer of the Company have evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as of September 29, 2012 and, based on their evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these controls and procedures are effective. Disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures are also designed to ensure that information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

There has been no change in the Company's internal control over financial reporting that occurred during the Company's fiscal quarter ended September 29, 2012 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents**PART II OTHER INFORMATION****TOOTSIE ROLL INDUSTRIES, INC.****AND SUBSIDIARIES****ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

The following table summarizes purchases of the Company's Common Stock during the quarter ended September 29, 2012:

| Period                  | (a) Total<br>Number of<br>Shares<br>Purchased | (b) Average<br>Price Paid per<br>Share | Shares<br>Purchased as Part of<br>Publicly Announced Plans<br>Or Programs | Approximate Dollar<br>Value of Shares that<br>May Yet Be Purchased<br>Under the Plans<br>or Programs |
|-------------------------|---|--|---|--|
| <b>JUL 1 TO JUL 28</b>  | <b>65,148</b>                                 | <b>\$ 24.34</b>                        | <b>NOT APPLICABLE</b>   | <b>NOT APPLICABLE</b>  |
| <b>JUL 29 TO AUG 25</b> | <b>88,082</b>                                 | <b>24.49</b>                           | <b>NOT APPLICABLE</b>   | <b>NOT APPLICABLE</b>  |
| <b>AUG 26 TO SEP 29</b> | <b>134,145</b>                                | <b>26.34</b>                           | <b>NOT APPLICABLE</b>   | <b>NOT APPLICABLE</b>  |
| <b>TOTAL</b>            | <b>287,375</b>                                | <b>\$ 25.32</b>                        | <b>NOT APPLICABLE</b>   | <b>NOT APPLICABLE</b>  |

While the Company does not have a formal or publicly announced stock purchase program, the Company's board of directors periodically authorizes a dollar amount for share purchases. The treasurer executes share purchase transactions according to these guidelines.

**Item 6. EXHIBITS**

**Exhibits 31.1 and 31.2 Certifications Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.**

**Exhibit 32 Certification Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**

**Exhibit 101.INS - XBRL Instance Document.**

**Exhibit 101.SCH - XBRL Taxonomy Extension Schema Document.**

**Exhibit 101.CAL - XBRL Taxonomy Extension Calculation Linkbase Document.**

**Exhibit 101.LAB - XBRL Taxonomy Extension Label Linkbase Document.**

**Exhibit 101.PRE - XBRL Taxonomy Extension Presentation Linkbase Document.**

**Exhibit 101.DEF - XBRL Taxonomy Extension Definition Linkbase Document**

Table of Contents

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**TOOTSIE ROLL INDUSTRIES, INC.**

**Date: November 7, 2012**

**BY: /S/MELVIN J. GORDON  
Melvin J. Gordon  
Chairman and Chief  
Executive Officer**

**Date: November 7, 2012**

**BY: /S/G. HOWARD EMBER, JR.  
G. Howard Ember, Jr.  
Vice President Finance and  
Chief Financial Officer**